



Economic Trends Report

Egypt

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Embassy of the United States of America

This report is a product of the Economic and Political section of the American Embassy, Cairo, Egypt. The Embassy welcomes questions or comments on this report. Comments should be directed to:

Economic and Political Section
American Embassy
Cairo, Egypt
Tel: (20-2) 795-2555
Fax: (20-2) 797-3491

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MAJOR TRENDS AND OUTLOOK

Egypt's economy since the Embassy's last report in July 2001 through mid-2002 has performed below expectations, although there have been some promising developments in economic legislation and other reform measures. A two-year slowdown in economic growth has been exacerbated over the past year by the impact of post-September 11 events on Egypt's economy and some economic policies that have impeded growth. Most observers believe overall economic growth for the 2001/02 fiscal year which ended June 30, 2002 (FY 01/02) was in the 0-2% range. Recovery in tourism and other sectors could add a percentage point or two in 2002/03, but growth beyond that range will depend upon clear policy direction and thorough implementation of the government's economic reform program.

Although detailed data is not available, private sector output probably fell over the past year, balanced partly by sharp growth in government spending. The global slowdown in travel after September 11 resulted in a 22% drop in tourism revenues, Egypt's largest foreign exchange earner and a major engine of economic growth, through the first three quarters of FY 01/02 (July 2001-March 2002). Most other sectors saw little or no growth, with construction, heavy industry, and durable goods remaining the weakest sectors. The gas exploration/development and IT sectors were exceptions to the rule in 2001 and early 2002, both continuing to grow strongly.

Despite concerns about the balance of payments impact of September 11, Egypt's overall balance of payments, while still in deficit, actually has improved over the past year. The merchandise trade deficit improved dramatically as imports, slowed by the recession and difficulty in obtaining foreign exchange, fell more than exports. However, the tourism fall-off, some decrease in Suez Canal revenues, continuation of weak foreign investment flows, and episodes of capital flight kept the entire balance in the red.

Egypt's monetary and foreign exchange policy is not satisfying the demand for foreign exchange and the lack of foreign exchange constitutes a serious impediment to economic growth. Despite a cumulative 17.4% devaluation in pound terms (15% in dollar terms) since August 2001 (and 32% in pound terms or 25% in dollar terms, since June 2000), pressure on the pound continues. A promising start to foreign exchange regime reform in August 2001 was overtaken by the September 11 events. A further devaluation in December 2001 did not solve the imbalance. A parallel market in foreign exchange reemerged because of the dollar scarcity and carried a premium of 10 % percent or more over the legal commercial maximum throughout the first half of 2002. Both Egyptian and foreign companies had to resort increasingly to acquiring dollars on the parallel market in the first half of 2002 because of unavailability of foreign exchange through the banking system.

The pound's devaluation contributed to an increase in inflation in 2002. Price controls and subsidies limited the impact on much of the population, but inflation appears to be significantly above the officially reported level of under 3%. Interest rates declined somewhat, but banks remained reluctant to loan in the current atmosphere. Government

expenditures increasing by over 10% annually, combined with a recession-induced drop in revenues, pushed the budget deficit towards worrying levels -- at least 5% of GDP in 2001/02 on a consolidated basis, inclusive of the social security surplus.

Despite the problems noted above, Egypt still has strong factors in its favor. Foreign debt and debt service remain low, with most debt long-term and concessional. Foreign exchange reserves cover more than 10 months of imports. Inflation is still within the acceptable range. The outlook for some sectors of the economy, particularly tourism and gas, is bright, although tourism remains subject to global and regional shocks.

Privatization of state-owned assets has remained slow, although there were a few success stories in the first half of 2002. Attempts to reform the foreign exchange regime, as noted above, have not been successful in restoring liquidity to the market. The foreign exchange situation, combined with steps such as a short-lived attempt at import restrictions in November 2001 and prohibitive clothing tariffs imposed in January 2002, further undermined business confidence and contributed to capital flight. Egypt's economy remains hampered by high tariffs, taxes, severe customs and port inefficiencies, and bureaucratic red tape that hurt competitiveness both domestically and internationally.

On the positive side, the government made substantial progress on several key reform steps in the first half of 2002. The People's Assembly passed a vastly improved comprehensive Intellectual Property Rights (IPR) Law, as well as a Money Laundering Law, a Special Economic Zones Law, and an Export Promotion Law. Egypt became a member of the WTO Basic Telecommunications Agreement. It undertook an IMF-sponsored review of the stability of its financial system and appeared more serious about efforts to improve its customs and other import-export mechanisms. However, the benefit of these measures will come only with effective implementation. Moreover, continued progress on reforms will be necessary if the Egyptian economy is to attract the domestic and foreign investment it needs to return growth to pre-2000 levels of 5-6%.

KEY ECONOMIC TRENDS AND ISSUES

Macroeconomic Outlook: Egypt's economic performance and reform program in the 1990's gained plaudits from international observers for increasing growth while sharply reducing inflation and the budget deficit to low single digits. However, the combination of external shocks in 1997-98 and 2001 (September 11) with a slowdown in reform efforts reduced growth sharply over the past two years. Official figures (revised downward in June 2002) put growth for the fiscal year ending June 30, 2001 at 3.3% and estimated growth for FY 2001/02, which ended June 30, 2002 at 3.1%. Most outside observers believe growth for 01/02 was lower, in the zero to 2% range. These figures combine strong growth in government expenditures (averaging over 10% annual increases) and a few isolated sectors with sharply negative growth for most of the private sector in FY 00/01 and 01/02.

The Egyptian government estimated inflation at 2.4 % for 00/01 and roughly 2.5% for 01/02. Many outside observers suggest inflation levels are somewhat higher after the price increases of early 2002, although still comfortably in the single digits.

Unemployment is officially estimated at 9%, up from 8.4 % in 00/01. These numbers reflect upward revisions in June 2002. Other observers suggest the effective rate of unemployment is significantly higher. Underemployment is also a major problem in Egypt, as in most developing countries. Lack of private business access to credit, weak consumer demand, foreign exchange shortages, and excessive government bureaucracy are frequently cited problems. The business and investment communities look to the Egyptian authorities to revive economic growth through a comprehensive, integrated government strategy to address key policy issues and reinvigorate the country's program of structural reform.

Foreign debt increased slightly in 2001 and early 2002 as a result of the Egyptian government's floating of a \$1.5 billion Eurobond offering and other borrowing, but remains comfortable at under \$30 billion, or roughly one third of GDP. Over three quarters of that debt is sovereign, with a major portion of it concessional and long-term. Debt service remains comfortable, at about 10% of current account earnings.

Despite these positive debt figures, Standard and Poor's downgraded Egypt's sovereign credit rating from the investment grade of BBB- to the speculative grade of BB+ in June 2002. Some other international rating agencies followed with outlook downgrades. Reasons cited were chiefly the expanding fiscal deficit and domestic debt, continuing problems in foreign exchange availability, and the overall slowdown in economic reform.

Fiscal Developments: Although the Egyptian government revised estimates of past budget deficit for 1998/99 and 99/00 upwards from earlier projections of around 1% of GDP, at the time it was the trend rather than the total that was worrying. Current budget deficit estimates for FY 01/02 and FY 02/03 (which began July 1, 2002) are higher. In line with IMF guidelines, the government has revised its budgetary accounts to show three increasingly broad measures of the budget and deficits: a narrow budget that includes only line government agencies and programs; a broader definition that includes transfers to or from independent state-owned agencies, and a third definition that also includes the social insurance funds (social security), currently in surplus because of Egypt's growing working-age population. Earlier estimates of the budget deficit were roughly based on the second figure; the government now has adopted the broadest definition as its benchmark of the deficit.

Based on the broadest definition, the government's budget deficit grew from 1.2% of GDP in 99/00 to 2.1% in 00/01. The budget deficit stood at 3.5% of estimated full-year GDP through the first three quarters of FY 01/02 and we estimate the full-year total will be approximately 5% of GDP. The government's budget for 02/03 projects a deficit of 4.2% of GDP. The widening of the budget gap is due to continuing strong increases in expenditures combined with stagnating revenues. Total expenditures and net lending (using the broadest definition) grew 6.1% from 99/00 to 00/01, and were projected to grow 11.4 % from 00/01 to 01/02. By contrast, total revenues and grants grew by only 3.4% from 99/00 to 00/01 and a projected 7.2% from 00/01 to 01/02. Although the government projects total revenues growing around 8% in 02/03, those figures may be optimistic.

The slowdown in imports (and thus tariff revenues), lower-than-expected income and sales tax revenues, and flat or relatively declining transfers from state-owned economic authorities (chiefly the state oil/gas company EGPC, the Suez Canal Authority, and the Central Bank) all have contributed to the slow revenue growth. On the expenditures side, salary increases and interest on government debt both have been growing at double digit rates. The government's budget announcement cited subsidies of LE 7 billion for some basic commodities and services, but other explicit or implicit subsidies are not reported. For example, the Minister of Petroleum recently was quoted as saying petroleum products sold below international or market prices now represent an LE 15 billion subsidy. The pound's devaluation contributed to the increase in both implicit and explicit subsidies.

The government committed in mid-2000 to paying off arrears of over one year to domestic suppliers. The Prime Minister announced in an April 2002 speech that all arrears dated before June 30, 2001 had been settled, but the level of new arrears accrued over the past year is unclear. The ability of the Ministry of Finance to assert budget discipline over expenditures and turn around weak growth in revenues will be crucial to reining in the growth of the budget deficit in future years and ultimately reducing it. The government committed at the donors consultative group meeting in February 2002 to perform a public expenditures review, but has not yet begun this process.

The FY 02/03 budget (July 2002-June 2003) put total expenditures at LE 141.64 billion (an increase of LE 15 billion over 00/01) and total revenues (including the LE 13 billion social insurance fund surplus) at 124.5 billion, for a deficit of LE 17 billion. These figures do not appear to match the new budget accounting methods noted above in their entirety, so caution should be used in comparisons. The People's Assembly approved the budget in June. The government has stated that its budgetary priorities remain mostly social: reducing unemployment; preventing erosion of salaries and employment in the state sector; and maintaining subsidies on essential commodities, health care, and education.

The largest proportion of the budget, LE 57.8 billion, or 41%, is earmarked for social expenditures. One quarter of the budget, or LE 34.8 billion, will go to paying the public sector wage bill, including a 10% wage increase for government employees. A further LE 38 billion will pay for servicing the government's domestic and foreign debt. The budget projected LE 7 billion for subsidies covering basic commodities and services, including sugar, bread, transportation, subsidies for agricultural crops and pharmaceuticals and dairy products. There are however other subsidies not included in the budget line, like energy subsidies, that could raise subsidies beyond the publicized levels. LE 30 billion will support state-run economic authorities. The LE 19 billion-investment budget will support government "mega-projects" such as the Toshka agricultural scheme (see below), Al Salam canal to carry irrigation water to the North Sinai, and the East Port Said development project, as well as other infrastructure priorities.

Businessmen almost uniformly cite high tariffs, inefficient customs processing, and other import procedures as a major impediment to trade and Egypt's competitiveness. The government's issuance of a decree concerning the WTO Customs Valuation Agreement in June 2001 (after a WTO-approved one-year delay from the original implementation date) was seen as signaling the government's intention to modernize the customs regime. However, these efforts remain in the early stages, as the Customs Valuation Agreement has not yet been implemented fully. The government had serious discussions with several donors over the past year about the need for further customs reform, and passed a new Export Promotion Law (see below) with provisions designed to ease some customs problems. Continuing tariff reform, in line with Egypt's obligations under World Trade Organization (WTO) agreements, will likely result in lower tariff revenues, which the government hopes will be offset by economic growth. Egypt's General Sales Tax was converted to a true value-added tax effective July 2001. Reductions in taxes on manufacturers will be offset by taxes and better tax collection at the wholesale and retail level. A draft law that would reduce corporate tax rates from current highs above 40% to an average of around 30% has been circulated for comment and probably will be considered by the next People's Assembly session.

Monetary Developments: The Government has been seeking a new monetary and foreign exchange policy since it abandoned its fixed peg to the dollar in mid-2000. The peg had been successful in reducing inflation to low single digits, but proved untenable in the late 1990s as the pound became overvalued by at least 35% and Egypt's balance of payments position deteriorated. Attempts to defend the peg led to a sharp draw down in foreign exchange reserves and corresponding increases in interest rates beginning in 1999. After abandoning the fixed peg, the government eventually settled on a crawling or adjustable peg system, using a central rate determined by the Central Bank of Egypt. Banks and exchange bureaus are allowed to sell dollars within a prescribed band around that rate. Initially set at LE 3.85/\$ with a 1% trading band in January 2001, the rate was subsequently adjusted to LE 3.86 in May 2001, and LE 3.90 (with the band increased to 1.5%) in July 2001. Neither rate was able to bring supply and demand into balance as the parallel market rate had been hovering at or above LE 4/\$ since the end of 2000.

In August 2001, the Central Bank announced a new central rate of LE 4.15/\$ and widened the trading band to 3%, for a maximum legal exchange rate of LE 4.275/\$, higher than the prevailing rate on the parallel market. At the same time, it began selling larger amounts of foreign exchange into the banking system. For about 1 1/2 months, the system functioned well and markets cleared. In the wake of September 11 and its expected negative impact on Egyptian foreign exchange earnings, the CBE once again began sharply to limit sales of foreign exchange. In November 2001, the CBE recommended changes in procedures for financing imports, including the prohibition of the use of documentary collection. Although the instructions were quickly withdrawn, they contributed to a further loss of confidence in the foreign exchange regime and a burst of speculation against the pound.

On December 13, 2001, the CBE announced another devaluation, this time to LE 4.50/\$ (making the legal maximum LE 4.635/\$). This devaluation did not have the desired

effect of restoring market equilibrium in the market, nor did a further minor devaluation to LE 4.51 ((LE 4.65/\$ legal maximum) in mid-January 2002. Sharply decreased private dollar sales into the banking system combined with a virtual halt in CBE sales of dollars made dollars almost unavailable through the banking system. Speculation against the pound increased and the parallel market rate soared above LE 5/\$ by early January 2002. The rate approached LE 6/\$ on high foreign exchange demand during the annual pilgrimage season, before coming down in February on news of economic assistance pledges for Egypt at a donors conference (see below) and as more dollars flowed into the parallel market. However the parallel rate has hovered around LE 5-5.15/\$ (a premium of about 10% over the legal maximum) since that time. The CBE announced in December 2001 that it would not allow the country's foreign exchange reserves to decline further and that banks must rely on their own foreign exchange resources. With few dollar holders willing to sell at the legal rate, many private sector importers and individuals have had to rely on the parallel market for their dollar needs over the past six months.

On the domestic liquidity front, total liquidity (M-2) grew 15.5% YOY from April 2001 through April 2002, compared to 11.6% in FY 00/01. However, if the cumulative effects of devaluation on foreign currency deposits is discounted, M-2 grew at similar rates of 9.2% in 00/01 and 9.8% April 01-April 02. We expect the rate for the full FY 01/02 to be similar. According to government figures, dollarization (foreign currency deposits as a % of total liquidity) was 22.3 % in August 2001. We do not have more current dollarization figures, but estimate the current level to be about 23%.

The CBE actively sterilized its large sales of foreign exchange in August-October 2001 through "REPOs" of Treasury Bills, but has intervened much less frequently in the banking system since then as its dollar sales slowed down. Unlike FY 00/01, there were no changes in the CBE's discount rate, which has remained at 11% since April 2001. However in September 2001 the CBE announced two changes in bank reserve requirements in an effort to boost liquidity. The first was a 1% reduction in overall bank reserve requirements, from 15% to 14%. The second allowed limited inclusion of T-bills in banks reserves. Banking analysts estimated this step provided an effective reduction of 1.4%, bringing the effective reserve requirement ratio to 12.6%. In a further attempt to boost the economy, the cabinet and CBE announced in early 2002 that the CBE would loan LE 1.8 billion at 4% interest (substantially below market rates) to participating banks, who would on-lend it to consumers at 6% for purchase of Egyptian-produced consumer goods. In July 2002, the Central bank changed its method of calculating reserves from a 10-day average to a 30-day average, which should help smooth out fluctuations in the interbank market.

The issuance in June 2002 of a decree establishing a primary dealers systems for marketing of T-Bills and T-Bonds (see capital market section below) was one step in establishing the groundwork for the eventual establishment of a monetary policy regime that relies more on market mechanisms such as open market operations in government securities.

The interest rates on T-bills fell over the past year, from 9% in June 2001 to 7.2% in June 2002. The interbank loan rate, while much more volatile, also generally was lower. Commercial lending rates remained relatively high at 13-14%, but with inflation up, we estimate commercial real interest rates have declined somewhat from the extremely high levels in 1999-2001. Banks report that they are still cautious and are generally refinancing old loans and servicing longstanding customers rather than doing new lending. The CBE and government in general remain very active in working with banks to arrange rescheduling of loans for both large and medium-sized debtors.

Privatization: As of March 2002, 188 entities had been privatized since 1995, generating proceeds of LE 16.9 billion. However, only 13 Law 203 privatization transactions, with a total value of LE 1.1 billion, were carried out in 2001, compared to an average of 25-30 transactions worth LE 2.5-3.5 billion over the previous five years. The slowdown in privatization since mid-2000 has created doubts in the minds of many investors about the government's commitment to the program. Senior officials, including the Minister of Public Enterprise, continue to emphasize Egypt's commitment to the program. The Public Enterprise Office (PEO), the technical secretariat to the Ministry of Public Enterprise, has introduced alternative methods for privatization including asset unbundling and leasing with option to buy. Incentives for the sale of 66 companies that have been identified as distressed or loss makers were announced, including five-year tax exemptions and the removal of land value from the company's valuation.

Two prominent transactions in the first half of 2002 demonstrated that Egypt still has valuable assets to privatize. The first was a lease-to-purchase agreement, worth \$200 million over five years, for the Amriyah textile company (the first privatization in the textile industry) with an American company. The second was the sale through an open tender process of the Egyptian Glass Company to an Egyptian-Kuwaiti company for LE 308 million (\$66 million). Foreign interest in government shares of cement companies also remained strong, as evidenced by the sale of the Helwan Cement Co. (48% government share, remainder in free float) to the Arab Swiss Engineering Company (ASEC, 49% Swiss owned) in September 2001 for LE 1.2 billion (\$281 million at the time).

Balance of Payments: Egypt's balance of payments position for the fiscal year ending in June 2001 (FY 00/01) was the best in several years. That overall picture continued into 01/02 despite the impact of September 11. In FY 00/01 the combination of lower imports, slightly higher exports and service proceeds left the current account deficit at only \$33 million, compared with \$1.16 billion in 99/00. The overall balance improved from a deficit of \$3 billion in 99/00 to only \$843 million in 00/01. The BOP continued to improve in the first quarter (July-September 2001) of FY 01/02 as Egypt actually ran an overall surplus, largely due to the proceeds from its \$1.5 billion Eurobond sale, and the overall balance through three quarters improved from a deficit of \$1 billion in 00/01 to \$666 million in 01/02.

Egypt's merchandise trade balance has improved dramatically over the past year, the deficit improving nearly 20% Year-on-Year (YOY) through the first three quarters of FY

01/02. The improvement is largely due to the continuing contraction in imports, which is itself associated with the weak economy, difficulty in obtaining foreign exchange, and the pound's devaluation. Imports through the first three quarters of FY 01/02 (July 2001-March 2002) amounted to \$10.9 billion, compared with \$12.5 billion during the same quarters in 00/01 and \$13.2 billion during the same quarters of 99/00. Those figures project to a full fiscal year total of only around \$14-14.5 billion, the lowest total in seven years. Imports fell 23% YOY in the third quarter of 01/02 (January-March 02), to \$3.2 billion, compared to \$4.1 billion in January-March 2001.

Exports also fell Year-on-Year through three quarters, but by a much smaller amount, from \$5.3 billion in July 00-March 01 (and \$4.4 billion in the same period of 99/00) to \$4.9 billion in 01/02 (July 01-March 02). Non-oil exports increased YOY through three quarters, from \$3.3 billion in 00/01 to \$3.5 billion in 01/02, possibly because the pound's devaluation improved their competitiveness. However a 27% drop YOY in petroleum export revenues, from \$1.9 billion in the first three quarters of 00/01 to \$1.4 billion in 01/02, outweighed the increase in other exports.

Conversely, Egypt's traditional surplus on trade in services shrank 35.6% YOY, from \$4.5 billion in the first three quarters of 00/01 to \$2.9 billion in 01/02. In the wake of September 11, earnings from tourism, Egypt's largest foreign exchange earner, were down 22% YOY through the first three quarters of FY 01/02, from \$3.3 billion in 00/01 to \$2.53 billion in 01/02. Income from investments abroad fell even more, from over \$1.4 billion in the first three quarters of 00/01 to only \$737 million for the same period in 01/02. Suez Canal revenues dipped only slightly, while private transfers (chiefly worker remittances), which had shrunk 22% between 98/00 and 00/01, actually increased 4% YOY during the first three quarters of 01/02. With the improvement in the merchandise balance largely offsetting the services deterioration, the Current Account deficit only increased slightly YOY through three quarters, from \$115 million in 00/01 to \$186 million in 01/02. Egypt actually ran a Current Account surplus of \$194 million in January-March 2002.

Aside from the Eurobond offering, the news on the Capital Account has been much less positive in the past two years. Net Foreign Direct Investment (FDI) fell from \$1.6 billion in FY 99/00 to only \$509 million in 00/01, and amounted to only \$388 million in the first three quarters of 01/02. Net inward portfolio investment has been weak since the South East Asian economic crisis of 97/98. It totaled only \$260 million in 00/01, compared with a high of almost \$1.5 billion in 1996/97 and net outflows in the following two years. Net inflows for the first three quarters of 01/02 reached only \$67.3 million, reflecting weak conditions both globally and on the Egyptian stock market. Net errors and omissions figures for the October-December 2001 quarter implied significant capital flight occurred.

It is unlikely that imports can be compressed much further without significant damage to the economy in general and import-dependent export industries in particular. A more likely scenario is that imports will begin to rebound, with their increase outstripping that of merchandise and service exports. Foreign exchange availability and price will

continue to play an important role in the trade balance. Tourism revenues probably will continue to recover from the post-September 11 impact and may return to pre-2001 levels over the next year or two. Longer-term prospects are good (see separate section below). The pound's devaluation vis-à-vis the dollar over the past two years will stimulate tourism and non-oil exports, as will the 11% depreciation of the dollar (and the dollar-pegged pound) against the Euro, the currency of Egypt's main trading partners and tourism customers, since the start of 2002.

Still, substantial increases in non-oil exports are likely to come in the middle rather than short term. Oil exports are likely to continue declining, probably ceasing altogether in under a decade unless significant new reserves are discovered. Egypt already is a net hydrocarbon importer in financial terms, as it must pay in dollars for oil and gas it purchases for domestic consumption from its concession partners. Egypt currently has no ability to export its gas surplus and significant gas exports will not come on line until at least 2004. Earnings from the Suez Canal and worker remittances are likely to remain more or less stable. Hence the prospect is for an increasing Current Account deficit over the next 12-24 months, requiring an increase in capital inflows, either through increased borrowing or more foreign investment, to cover it. Whether those capital flows materialize depends to a large degree on continuation of the government's reform program, particularly in the areas of monetary, fiscal, privatization, infrastructure, and business environment policy.

Direction and composition of trade: The European Union (EU) as a bloc remains Egypt's largest trading partner, accounting for 35-40% of Egypt's imports and exports. If implemented, Egypt's Partnership Agreement with the EU (see section on "Regional Integration") could result in a significantly larger volume of trade. The U.S. comes next (and is Egypt's largest trading partner as a country), accounting for around 20% of Egypt's merchandise imports and 11% of its exports. Asian countries account for around 25% of both imports and exports. Countries in the Middle East take 16% of exports and account for about 8% of imports, while Africa and Latin America account for less than 5% each of imports and exports.

Egypt's leading merchandise export is crude oil and petroleum products (\$2.3 billion in 2001), followed by finished goods (chiefly textiles and apparel), and raw materials (cotton and other agricultural products). Leading imports include capital equipment and agricultural commodities. Chief U.S. exports to Egypt include agricultural commodities (around \$1 billion annually), capital goods, and equipment. Egypt's exports to the U.S. (\$778 million in 2001) are predominantly textiles, clothing, and crude oil.

MAJOR LEGISLATIVE DEVELOPMENTS

Egypt's parliament, the People's Assembly (PA) approved several key pieces of economic legislation in May and June 2002. The Assembly approved the Money Laundering Law on May 22, the Intellectual Property Rights (IPR) Law and Special Economic Zones (SEZ) Law on May 29, and the Export Promotion Law and Unemployment Insurance Law on June 16.

The Money Laundering law was proposed to address concerns expressed by the OECD Financial Action Task Force on Money Laundering (FATF) regarding the lack of a comprehensive legal regime in Egypt to counter money laundering. In June 2001, FATF placed Egypt on a list of "Non-Cooperative Countries or Territories" (NCCTs) whose money laundering regimes did not meet international standards. The chief complaint against Egypt was its lack of a specific law criminalizing money laundering.

The comprehensive IPR law covers patent, trademark, copyright, and industrial design protections. Its drafters intended that the law would, inter alia, bring Egypt's legal IPR regime into line with its obligations under the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement. Initial indications are that the law goes a long way towards meeting TRIPS standards. The American pharmaceutical industry association, Pharmaceutical Researchers and Manufacturers of America (PHRMA), issued a press release welcoming the new law. However, careful analysis will be required to determine if the law and its subsequent implementation are fully consistent with Egypt's obligations under TRIPS.

The Special Economic Zones (SEZ) Law allows the establishment of special industrial zones, designed specifically with the export market in mind, which would be allowed to import capital equipment, raw materials, and intermediate goods duty free. Companies established in the new zones also would be subject to lower corporate and sales taxes, operate under more flexible labor regulations, and enjoy other incentives. Egyptian government officials view the SEZs as a model for eventual emulation throughout the country. The media, however, reported existing business concerns that the new law would create a parallel economy, with newly-established firms operating in a more attractive investment environment, while existing firms continue to face a much more cumbersome and costly regulatory and tax situation.

The Export Promotion Law restates the authority of the Ministry of Foreign Trade's General Organization for Import and Export Control (GOIEC) over import inspection procedures. It seeks to improve the customs rebate system for exporters by establishing a central unit, under the joint supervision of the Ministries of Finance and Foreign Trade, to oversee the system. It also establishes an "export promotion fund" funded at least in part by fees leveled on imports, but neither the nature of the fee (new or existing) nor the activities of the fund are clear. Implementing regulations that presumably will clarify the new law's provisions have not yet been issued.

The unemployment insurance law, officially known as the Emergency Subsidy Fund Law, establishes a fund to compensate workers/employees whose wages are suspended due to firm closure or downsizing. According to press reports, the Fund's resources will come from a 1 percent deduction from the base salaries of public, public enterprise and private sector employees in firms with over 30 workers, a government contribution and other donations. No further details on implementation were available at the time this report was completed. This law originally was conceived as part of a more comprehensive Labor Law, which has been in the drafting and discussion stages for most

of the past decade. This draft law, which proposes major changes, including liberalizing workers' right to strike as well as employers' rights to hire and fire, was "passed in principle" by the People's Assembly in June 2002. It will be considered formally by the next parliamentary session beginning in November 2002.

SECTORAL TRENDS AND PRINCIPAL GROWTH SECTORS

Services account for roughly 50% of Egypt's GDP, with tourism and Suez Canal revenues being particularly important.

Tourism: Tourism is Egypt's largest foreign exchange earner, as well as a key engine of growth. Officially reported foreign exchange earnings from tourism are only about 5% of GDP, but a 2001 report by the Egyptian Center for Economic Studies implies tourism's real direct and indirect impact on GDP is 11%. The tourism sector rebounded sharply from a steep decline after the 1997 terrorist attack in Luxor to hit record levels of 5.5 million tourist arrivals and \$4.3 billion in earnings in 2000, but it has been negatively affected by the political tensions in the region and September 11. Tourist arrivals fell by 15.6% YOY in 2001 and 16.7% YOY in the first quarter of 2002. Tourism revenues were down 33% YOY in Egypt's high season (October 2001-March 2002, and down 22% YOY for the first three quarters of FY01/02 (July 2001-March 2002).

In recent years, Europeans have accounted for around two-thirds of all tourist arrivals. Tourist arrivals from Israel dropped precipitously and arrivals from the U.S. dropped moderately in the last quarter of 2000 and first part of 2001 in response to the violence in Israel, the West Bank, and Gaza, but European tourism remained at high levels. Following September 11, tourist arrivals dropped sharply in September through November, but rebounded somewhat in December 2001 and reached pre-September 2001 levels in March 2002. The composition of the tourism also shifted, with budget travelers (including larger contingents from Eastern Europe and the states of the former Soviet Union) replacing some traditional higher-end tourists from Italy, German, and France. The change in clientele, combined with price cuts to attract tourists, have led to a revenue decrease greater than that in arrivals. Employment in tourism and other related sectors was negatively impacted, as the shock came at the start of the high season. The Prime Minister announced at the Donors Consultative Group meeting in February 2002 that the number of jobs lost in the tourism and transportation sectors was expected to reach 387,000, or 2% of total employment. Construction and opening of new touristic resorts and projects was delayed following the September shock and some hotels initially were operating at below 20% capacity.

However, the situation has started to improve with occupancy rates increasing in the Red Sea resorts and arrival of the traditional influx of Arab tourists in June 2002. Mid to long-term prospects for the industry are bright, although they continue to be subject to exogenous political shocks. Government and private business have ambitious plans to expand tourist arrivals to 9.5 million by 2005. In addition to the famous antiquities around Cairo, Luxor, and Aswan/Abu Simbel, the government hopes to expand visits and

services at lesser-known archaeological sites and has started promoting the development of virgin areas along the southern Red Sea coast and the Western Desert.

Beach tourism now rivals historical tourism, and major hotel construction continues along the Sinai and Red Sea coasts, which host some of the world's finest coral reefs. Developers are expanding golf and conference facilities to expand options for visitors. The prevailing domestic credit crunch and overbuilding in some new resort areas has led to a slowdown in new construction, but the Red Sea resorts are likely to attract increasing numbers of tourists. They also will provide increasing opportunities for exporters of hotel equipment and environmental management services. Airports and other infrastructure being built to serve the new resorts provide additional opportunities for U.S. exports and investment (see section on "Transportation and Infrastructure").

Suez Canal revenues have been flat or declining for the past decade because of increased global reliance on other means of transportation (chiefly pipelines and air) for trade. Despite concerns that high war risk insurance premiums and lower world trade in the wake of September 11 would sharply reduce revenues, the Suez Canal Authority reported revenues in the just-completed FY 01/02 were down only 7% from 00/01's total of \$1.84 billion. Increased military traffic partially compensated for a drop in commercial traffic. A dredging program completed in 2001 deepened the canal to permit use by supertankers, but the long-term prospects are for slow or no growth in revenues.

Banking: Despite the presence of over 60 banks, Egypt remains "under-banked" in many ways. The four large state-owned banks continue to account for over 50% of total assets. However, most observers believe a significant share of their loan portfolio goes to supporting inefficient, loss-making state-owned companies. Banking sources say Banque du Caire, earlier considered the most vulnerable of the state-owned banks, has significantly reduced its non-performing loan ratio over the past year under a new management team of Egyptian, mostly ex-CitiBank, officials. Although late 1990's legislation allowed privatization of the "Big Four," there currently are no plans to do so. Several smaller private-owned banks are more dynamic market leaders in areas such as consumer credit, automation and credit card services. The smallest 40 banks account for a very small share of total banking sector assets and activity. Since early 2001 the government has advocated the merger of some of the smaller banks, but no concrete deals have emerged so far. Likewise, despite repeated media speculation about possible sale of the government's shares in Egyptian American Bank, Al Watany Bank, and Misr American International Bank over the past year, no sales have been made.

Officially, non-performing loans are around 14% of total loan exposure in the banking system. Although other observers put them at closer to 20%, most agree that the situation has improved over the past year. The government conducted an IMF/World Bank-assisted Financial Sector Assessment Program (FSAP) during the first half of 2002, which should provide a better sense of the sector's strengths and weaknesses. The new Central Bank Governor has insisted that the state-owned banks improve their e-connectivity and expressed a desire to further improve bank supervision methods and systems.

Banking activity remained relatively depressed over the past year. Continued caution in lending combined with sharply lower import levels (and thus, lower issuance of letters of credit and other trade-related banking services) to reduce earnings and profitability for many banks. Despite the government's successful efforts to arrange rescheduling programs for many large private debtors, concerns about poor credit risks and bad loan exposure are likely to constrain lending somewhat through 2002 and into 2003. The new mortgage law passed in June 2001, executive regulations were promulgated in February 2002, and a new mortgage regulatory authority is in the process of being set up. Accordingly, little new lending has taken place under the law's provisions, but we anticipate this could begin to change and result in increased lending for real estate activities in 2003.

Capital Market: The Cairo and Alexandria Stock Exchange (CASE), like most stock markets around the world, did not have a good year. Its performance from mid-2001 through mid-2002 was characterized by stagnation, with brief rallies consistently cut short by global, regional and local events. The benchmark Hermes Financial Index (HFI) entered July 2001 on a downward trend and continued falling to a seven-year low of 5322.08 by the end of the month. It rebounded sharply in August in response to the pound's devaluation and news on privatization deals, gaining almost 20% to reach 6406.95 on September 10. It followed the global trend downward after September 11 and the drop was further aggravated in November 2001 by news that the CBE had prohibited the use of collection bills in importing, leading to another HFI seven-year low of 5085.62 on November 22. The market continued its fall, responding to the foreign exchange situation and the lowering of Fitch IBCA and Moody's outlook on the Egyptian economy and four banks, closing January 2002 with yet another low of 4849.83, a level not registered since April 1994. Trading remained stagnant in the first half of 2002, with intermittent surges in trading and prices linked to privatization rumors or other events (such as the February donors meeting announcement on economic assistance to Egypt), followed by profit taking. The HFI climbed slowly from the January low to 5300.22 points on June 30.

Net foreign portfolio investment flows declined sharply to only \$67.9 million during the first three quarters of FY 01/02, compared to \$287 million in the same period of 00/01. Trading volume and value increased in the second half of 2001 compared to the first half, but they dropped significantly in the first five months of 2002 reflecting the impact of the economic recession and regional tensions. As of May 2002, market capitalization of the Cairo and Alexandria Stock Exchange stood at approximately LE 118 billion, with 1,110 companies listed.

In May 2002 the Minister of Finance issued decree number 480 of 2002 establishing the Primary Dealers System, which is expected to come into effect in September 2002. The new system, which is being established with the assistance of the USAID Capital Market Project, allows financial institutions registered with the Ministry of Finance, including banks and bond dealers, to underwrite primary issues of government securities and activate trading in the secondary market through sale, purchase and repurchase

agreements of government securities. It includes an electronic auction system for Treasury Bills. In March 2002 EFG-Hermes and Commercial International Investment Co. (CIIC) merged, creating the largest financial institution in the Egyptian market and the only registered bond dealer to date.

Primary Dealers will be allowed to trade government securities on the open market provided they notify the CASE of their purchase and sale of the securities. As a result of the new system the cost of borrowing and public debt service is expected to decrease in the long run. It also should help establish a proper yield curve reflecting actual supply and demand for government debt and encourage a more efficient bond market. As of June 2002 there were LE 13 billion in T-Bonds and LE 40 billion in T-bills outstanding.

A new profit repatriation system was announced by the CBE in June 2002 whereby sub-custodian banks are required to open two accounts for foreign investors (global custodians), a foreign currency account and a local currency one, which will be exclusively maintained for stock exchange transactions only. The two accounts will serve as a channel through which foreign investors will process their sale, purchase, dividend collection and profit repatriation transactions using the official exchange rates.

Although the stock market has not fared well the past year in terms of trading, institutional changes are being introduced, including new listing and delisting regulations and Over the Counter Trading, that aim at developing the market structurally in anticipation of a turnaround once overall macroeconomic conditions improve.

Other Services: Egypt remains under-served by insurance services, with annual premiums accounting for only about 1.1% of GDP. The government reported total insurance sector assets at LE 14.4 billion at the end of FY 00/01. State-owned insurance and re-insurance companies dominate, as in banking, with over 70% of the market. However, the government has begun to allow foreign companies to enter the market. There are currently at least four foreign insurance companies operating in Egypt, including the American International Group (AIG), which bought Pharonic Insurance in early 2001. If the government follows through on plans for further reform of the sector, including privatization of state-owned firms, there is likely to be substantial room for growth and foreign investment. Official valuations of the four large state-owned insurance companies, an important step towards privatization, were completed in mid-2001. The amount of insurance that each company must compulsorily reinsure with state-owned Egypt Reinsurance continues to be phased out, with 2003 as the termination date. As with insurance companies worldwide, the insurance industry in Egypt was hit by increased costs in the wake of September. New costs were generally indirect ones, although state-owned Misr Insurance reportedly suffered losses from its participation in limited share insurance of United and American Airlines aircraft. Surcharges (of up to five percent) were added to rail and airline ticket prices to compensate for higher insurance premiums. Foreign insurance companies reported difficulty in obtaining foreign exchange to pay for reinsurance premiums.

Energy: The oil and gas sector officially accounts for 7% of GDP. Gas exploration and production has been one of the brighter spots in the economy over the past two years. We expect that trend to continue based on recent gas discoveries and investment plans. Oil production and exports have been a mainstay of the Egyptian economy and exports over the past 20 years, with the original Gulf of Suez base of production being supplemented by production in the Nile delta (mostly onshore and offshore gas) and the Western Desert. The oil and gas sector continues to account for the bulk of foreign investment in Egypt, including such industry giants as BP, British Gas, ENI, and Shell.

Crude oil production has been in decline for several years, from a high of more than 920,000 barrels per day (BPD) in 1995 to less than 640,000 BPD in 2001 and an average of less than 630,000 BPD in the first quarter of 2002, while domestic consumption increased from 412,000 BPD in 1997 to 460,000 BPD in 2001. Proven reserves continue to decline, from about 4 billion barrels in the early 1980's to less than 3 billion barrels in late 2000. Absent significant new discoveries, Egypt is likely to cease being an oil exporter before 2010. As noted above, it already is a net importer of hydrocarbons in financial terms, as it must pay for the share of its partners' oil and gas production that is consumed domestically. On the other hand, gas production and reserves continue to rise. Natural gas production and reserves have been growing by 10% or more each year. Production increased from about 1.4 billion cubic feet per day (BCFD) in 1997 to approximately 2.4 BCFD in 2001. Reserves have more than doubled in the past seven years to over 55 trillion cubic feet (TCF) of proven reserves. Probable reserves total another 65 TCF. Egypt already generates most of its electricity from natural gas.

Houston-based Apache Oil Company is now the single largest American investor in Egypt, with a total investment of over \$1.7 billion (as of end of April 2002) and concessions in the Western Desert as well as offshore in the Delta. In November 2000, Texas-based Ocean Energy, prospecting in the Gulf of Suez Ras Al Zeit lease, found a field with reserves ranging between 40 and 80 million barrels of oil, the largest crude oil discovery in Egypt in ten years.

With new natural gas discoveries outpacing projected domestic demand and oil export volumes on a sharp downward path, Egypt is working hard to find export markets and develop export capacity for its gas. Earlier plans to pipe up to 3 BCM (106 BCF) per year to Israel still remain a possibility if regional tensions decrease. Exports to Turkey by pipeline are also a longer-term prospect, but Egypt has much competition. Egypt has had significant successes in smaller pipeline deals and liquefied natural gas (LNG). In 2001, Egypt reached contractual agreements for sale of gas to Jordan via a new pipeline from the existing pipeline terminus in El Arish, North Sinai to Taba, then across the Gulf of Aqaba. With construction already beginning on parts of the pipeline, exports of approximately 39 BCF/yr are expected to begin by April 2003. Egypt is also discussing the sale of gas to Lebanon and Syria through an extension of the Jordan pipeline.

LNG projects also are proceeding apace. A British Gas (BG)-led consortium is building an LNG processing plant near Alexandria, with gas to be supplied from the BG fields offshore from the Nile delta. In January 2002, Gaz de France signed an agreement to

take the entire annual production of the BG plant's first train (3.6 mmt of LNG, equivalent to 175 BCF) for 20 years, starting at the plant's expected entry on duty date in mid- 2005. GdF also agreed to take a 5% share in the project. BG plans an identical, 3.6 mmt second train, which could come on line in mid-2006. Union Fenosa, a Spanish electric utility, is constructing a LNG plant in Damietta, also in the delta. The project aims for the construction of one train to export 3.2-5.2 mmt of LNG annually, with an entry on duty date of late 2004. Union Fenosa will purchase gas for this plant from the Egyptian grid. Industry sources estimate that investment in these plants could total \$3 billion from 2002 to 2006. Egypt could be the world's seventh largest LNG exporter by 2006, with gross export revenues rising from \$100 million in 2004 to around \$ 1.3 billion annually in 2007-08.

Manufacturing: Egypt's manufacturing sector accounted for approximately 20% of GDP in 00/01. Main sub-sectors include metallurgy, cement, fertilizers, textile/clothing, and consumer goods. Performance was almost uniformly below planned levels in 2001/02. The construction industry has been in decline since late 1999, as the government reduced funding for investment projects and as hotel, commercial, and residential construction was hit by the credit crunch and overbuilding. This has dampened demand for building materials. Cement sales fell from over 27 million metric tons (mmt) in 1999 to 26.4 mmt in 2000. They improved marginally to 26.7 mmt in 2001, but production and sales were flat or declined again in the first half of 2002. On a fiscal year basis, government reports show cement production from July 2001-May 2002 was 21.99 mmt, compared with 23.05 mmt for the same period in 00/01. The industry expects demand will not return to the 1999 level until at least 2004.

Steel production and sales fell very sharply in 2000 and remained flat in 2001. Domestic demand is still weak, but producers are optimistic that the pound's devaluation and increased export opportunities, particularly to the U.S. after Egypt's exemption from U.S. steel safeguard measures, will help boost production and sales in the second half of 2002. Production and sales of durable consumer goods also were down. Domestic automobile production, which had fallen 12.1%, from 45,416 units in CY 1999 to 39,616 in 2000, continued to fall in 2001 and the first quarter of 2002, according to the industry. Total vehicle sales (both imported and domestically-assembled) have fallen steadily, from 106,000 in 1998 to 69,000 in 2001, and industry sources say sales could be as low as 55,000 in 2002. Feeder industries are similarly affected. We expect these industries will take somewhat longer to recover previous production and sales volumes than the consumer goods industry.

The picture for consumer goods is likewise mixed. Egypt's state-owned clothing and textile factories account for 30% of total manufacturing sector employment, but continue to experience large losses because of outmoded equipment, over-employment, and inefficient operation. On the other hand, some private clothing manufacturers were very successful in expanding production and exports over the past two years, particularly to the U.S. The pound's devaluation has improved the competitiveness of these companies' exports. Food and other consumables industries, largely in private hands, remain

attractive destinations for foreign investment because of Egypt's large population, growing at about 2% per year. They also have substantial potential for growth in exports to Europe and neighboring Middle Eastern markets.

Agriculture: Agriculture remains one of Egypt's most important sectors and continues to achieve steady growth rates of 3-4% per year. Growing middle-income countries generally exhibit a decline in agriculture's share of GDP and employment, and Egypt is no exception. The sector's contribution to GDP has fallen gradually from 20% in FY 86/87 to 16.6% in FY 00/01, and the number of Egyptians employed in the sector has fallen, from 33.8% of the total labor force in FY90/91 to 28.4% in 00/01. The challenge for Egypt is to maintain and expand agricultural production for domestic and export markets while at the same time adding value and employment through the development of more agriculture-based processing activities.

Productivity gains since the mid-1980's, achieved through long-term government commitments to policy reform and liberalization coupled with assistance from donors (particularly USAID), have helped sharply increase grain and vegetable production, closing the gap between domestic food supply and demand. Cotton production has been in decline because of less favorable relative prices. That trend reversed somewhat in 2001, as more favorable prices for cotton and lower prices for rice caused a slight shift in cultivation back towards cotton, boosting its output. Wheat production was 6.2 million metric tons (mmt) and rice production was 3.6 mmt in 00/01. Nevertheless, Egypt remains a large food importer. It is the single largest overseas market for U.S. wheat, importing 5 mmt in 2001.

While still a small part of total exports, horticultural exports, chiefly to Europe, have become increasingly important in recent years. Egypt hopes that the Association Agreement with the European Union and development of the Toshka agricultural scheme (more on both below) will lead to large increases in fruit and vegetable exports. Food processing for both the domestic and export markets is an industry with substantial growth potential.

Construction on the South Valley Development or "Toshka" project began in January 1997 in the area bordering Lake Nasser, north of Abu Simbel. The project aims to irrigate some 500,000 acres of arable arid soil in Egypt's far south with water from Lake Nasser. The government says it has spent LE 2.2 billion of a planned total LE 5.7 billion on a massive pumping station and irrigation canals to transport the water. Saudi Prince Walid bin Talal's Kingdom Agricultural Development Corporation (KADCO) has purchased 120,000 acres, to be managed by the U.S. firm Cadiz/Sun World (which has a 10% investment stake in the KADCO project). This private sector project's aim is to grow fresh fruits and vegetable for export to Europe in the winter months. Government spending in the Toshka and other "mega-projects" has been subject to increased budgetary oversight over the past two years and the pace of construction slowed somewhat. The project will be inaugurated as scheduled in October 2002, but it is not clear whether all planned government infrastructure will be in place at that point.

Transportation and Infrastructure: Following Egypt's worst ever train disaster in February 2002, in which over 300 people died, the Minister of Transportation and the Chairman of the Egyptian National Railways resigned and the Ministry was split into a Ministry of Civil Aviation and a Ministry of Land and Sea Transportation. The government announced plans to upgrade railway rolling stock and provide travel insurance to passengers. In April 2002, the government announced small increases in prices for railway and Metro tickets (the first in ten years), but prices still do not cover operating costs for Egyptian Railways and the Cairo Metro (underground rapid transit system).

The last year also has been difficult for government-owned Egypt Air and Egypt's nascent private airlines. The worldwide increases in aircraft insurance premiums coupled with declines in tourist travel to Egypt have impacted Egypt Air profits. For the fiscal year ending June 30 2002, however, the company still reported a profit of LE 945 million on total assets of LE 12.5 billion based principally on tourism, ground handling and catering operations. The crash of an Egypt Air plane in Tunisia in May further damaged the company's bottom line and image.

At the same time, the government has made some potentially positive major changes in the way the aviation industry is organized. In addition to creating the new Civil Aviation Ministry, the government appointed new chairmen for Egypt Air and the Cairo International Airport. On July 1, Egypt Air was converted into a holding company with six affiliated companies covering airlines, maintenance and technical affairs, ground services, cargo, tourism, and air services. All six of the new enterprises in the holding company arrangement fall under the authority of the Ministry of Civil Aviation. The Egyptian Civil Aviation authority, now converted into the Egyptian Holding Company for Airports and Navigation, will have two affiliated companies: the Egyptian Airports Company and the Egyptian Navigation Company. As their names imply, the former will have responsibility for airport management and operations, while the latter will handle aviation safety, air traffic control, aircraft certification/registration, etc.

The government is proceeding with plans for an expansion of Cairo International Airport and planning for the eventual construction of new international airports and upgrades to existing airports such as Luxor and Sharm El Sheikh. Despite the tourism downturn, several new airports are in the works. Egypt's first BOOT airport, Marsa Alam on the southern Red Sea coast, opened in late 2001. Other airports also are being constructed or planned on a BOOT basis to serve new resorts on the Red Sea and Mediterranean coasts, such as El Alamein. Airport construction and expansion is likely to remain an important area for potential foreign investment in coming years.

The government earlier had indicated a desire to construct future power generation projects on a build-own-operate-transfer (BOOT) basis. Three BOOT power generation awards have been made to date, and one, with the U.S. firm Intergen as the major partner, began operating in early 2002. However, both the President and Prime Minister made public statements in early 2002 expressing concern about the cost of BOOT power that is sold to the public for pounds but must be paid to the investors in dollars. They said that in the future BOOT and BOT methods will be reserved for infrastructure projects that

generate hard currency, such as airports (see below). The government also is working on plans to corporatize the Egyptian Electricity Holding Company, a plan that will likely entail splitting power generation from distribution and offering up to 49% of the company to the private sector.

Information Technology and Telecommunications: The government has identified development of the IT sector as a national priority, and the Egyptian Government and private sector are eager to engage with U.S. firms in this area. Information technology (IT) in Egypt is in its early stages, but is growing quickly. The IT sector defied the overall economic trend in Egypt in 2001, growing an estimated 17%, but growth probably slowed to single digits (although still well above the overall pace for the economy) in the first half of 2002. Internet penetration remains low, with an estimated 600,000 internet users in Egypt in January 2002. A revenue sharing deal between Telecom Egypt and Internet service providers launched a subscription-free internet service in 2002, which has led to a small increase in internet usage.

Human resource constraints, inadequate infrastructure, legal and regulatory hurdles for E-commerce and lack of public awareness are constraints on the sector's growth. The Egyptian Government is aggressively working with the private sector and foreign partners, including USAID, to address these hurdles in an effort to stimulate rapid development. Laws to govern e-commerce are in the works. Microsoft has signed an agreement with the government to support the use of licensed software throughout the government.

The growth of cellular phone service in Egypt is another indicator of the rapid growth potential for IT in Egypt. The number of subscribers grew from 177,000 in 1998 to 3.6 million in January 2002, compared with only 7 million fixed telephone lines in the country. TE is proceeding with its plan to launch Egypt's third mobile phone provider (after private companies Mobinil and Vodafone) in 2003. Egypt's telecommunications regulatory authority ruled in early 2002 that TE must pay for the mobile phone license just as its predecessors did. TE has agreed to make the payments in installments, and expects to finish the payments by December 2002. The Government put earlier plans for a partial privatization of Telecom Egypt (TE) via the local and international stock markets on hold in 2000. Efforts to seek a strategic investor for the national company have not materialized thus far.

In June 2002, Egypt became a member of the WTO Basic Telecommunications Agreement (BTA), which commits it to allowing greater competition in its telecommunications market. It also is preparing an offer on joining the WTO Information Technology Agreement, which would lead to an eventual phasing out of tariffs on all IT products.

ECONOMIC COOPERATION

Regional Initiatives: In June 2001 Egypt and the European Union signed the Association Agreement that had been under negotiation since 1995. The European Parliament has

ratified the agreement, but it still must be ratified by Egypt and each EU member state. Ratification could take another 1-2 years. When in force, the agreement will give Egypt immediate increased access to the European market, particularly for its agricultural products. Tariffs and other barriers to European exports into Egypt will be phased out in stages. Tariffs on raw materials and capital goods for industry will drop to zero three years after the agreement enters into force, on semi-finished goods after 10 years, on consumer goods and finished products after 13 years, and on automobiles after 15 years. The agreement includes EURO 615 million in project assistance grants and EURO 1.1 billion in loans from the European Investment Bank, designed to help modernize Egyptian industry.

Egypt has a trade agreement with almost every Arab country. In January 1998, Egypt began implementing agreements reached with Arab League members in connection with the Arab Common Market treaty of the 1960s, which call for phasing out existing tariffs over a 10-year period. However long negative lists impede the effectiveness of almost all of these agreements. Egypt has been a member of the Common Market for Eastern and Southern Africa (COMESA) since mid-1998, and is committed to eliminating tariffs with COMESA members entirely by 2004. Neither Arab nor African markets are expected to generate major growth in Egyptian exports in the short to medium term.

World Bank Donors Consultative Group Meeting: The biennial World Bank Donors Consultative Group (CG) meeting for Egypt took place in February 2002, in Sharm el Sheikh. Originally scheduled for October 2001, the meeting was postponed to allow donors and the government to review Egypt's assistance needs in the post-September 11 environment. At the meeting, the Government of Egypt presented estimates of a \$2.5 billion balance of payments gap as a result of losses in tourism earnings and other events linked to September 11. It reported on reform steps taken to date and presented a policy paper with its reform agenda for the coming year. In that paper it committed itself to continuing the reform process, including, inter alia, maintaining a flexible exchange rate regime, and undertaking a Financial Sector Assessment and a Public Expenditures Review. Donors urged the government to accelerate the reform process, including privatization, foreign exchange reform, customs, reform, and privatization of state-owned banks.

Donors pledged \$10.3 billion in assistance over the 2002-2004 period, including both previously planned and new commitments. The total amount included a mix of soft and commercial loans and grant assistance covering projects, technical assistance, and balance of payment support. Of the total, \$2.1 billion was to be "quick-disbursing assistance available in 2002. The quick-disbursing assistance included \$1.5 billion in possible loans from International Financial Institutions (IFIs), but would require a "stable macroeconomic framework." As of end-June 2002, the government had not yet agreed with the IFIs on the outlines of this assistance.

U.S. Economic Assistance: The U.S. government has provided Egypt over \$25 billion in economic assistance since 1975. USAID has been instrumental in putting into place the foundations for economic growth, such as infrastructure (water, wastewater, power and

telecommunications) and a favorable economic policy environment for private sector development. The recent areas of concentration of the program have included job creation, economic growth and productivity, infrastructure, education, democracy and governance, population, health and nutrition, environment and natural resource management. USAID adopted in 2000 a new strategy that focuses on expanding the role of Egypt's private sector to help move Egypt from an assistance-based relationship to a relationship based on trade. New areas of concentration under this program include the development of the information technology sector, strengthening Egypt's capacity for human resource development, trade policy capacity building, and continuing efforts to enhance Egypt's export competitiveness.

Economic assistance levels averaged over \$800 million annually from the time of the Camp David accords (1978) until mid-1998. Food aid averaged over \$218 million/year starting in 1975, but ended in 1992 in light of Egypt's gains in agricultural self-sufficiency. As part of an overall revision in U.S. assistance policy, aid levels have, by mutual agreement with the Government of Egypt, been on a downward glide path since 1999. The USAID budget for Egypt for U.S. FY 2002 is USD \$655 million, and the anticipated budget for FY 2003 is \$615 million. Current planning is that economic assistance levels for Egypt will continue to be reduced by \$40 million per year to a level of \$407.5 million by 2009.

U.S.-Egypt Trade and Investment Framework Agreement (TIFA): Egypt and the U.S. signed a Trade and Investment Framework Agreement (TIFA) in 1999. The TIFA provides a mechanism for facilitating the concrete measures needed to continue moving the two countries towards freer trade. It established a Council on Trade and Investment composed of representatives of both governments and chaired by USTR and Egypt's Ministry of Economy and Foreign Trade. The Council has met only once, in November 1999. Meeting in Cairo in June 2002, the United States Trade Representative Robert Zoellick and Egyptian Minister of Foreign Trade Youssef Boutros Ghali discussed steps toward liberalizing trade between the United States and Egypt. They agreed to follow up with a TIFA Council meeting in October 2002.

U.S. Support for Trade and Investment: The Overseas Private Investment Corporation (OPIC), the U.S. Export-Import Bank (Ex-Im Bank) and the Trade and Development Agency (TDA) are committed to supporting the growth of U.S.-Egyptian bilateral trade and investment. These agencies provide loan and insurance products and services, such as support for feasibility studies on major investments involving U.S. inputs. A business development mission from Ex-Im Bank visited Cairo and Alexandria in May 2002 to explore possibilities for increasing its financing activities in Egypt. Information about Ex-Im Bank, OPIC, and TDA programs is available through their head offices in Washington or through the Embassy (see below).

The U.S. Department of Commerce's Foreign Commercial Service (FCS) and the U.S. Department of Agriculture's Foreign Agricultural Service (FAS) provide assistance to U.S. exporters through their offices in Washington and in the Embassy in Cairo. The Embassy's Economic and Political Section also can provide guidance to current and

potential American investors and information on current economic conditions in Egypt. See overleaf of front page for more information about these services.

POLITICAL ISSUES AFFECTING THE BUSINESS CLIMATE

Nature of Political Relationship with the United States: The United States and Egypt enjoy a strong and friendly relationship based on shared mutual interest in Middle East peace, stability and regional security, combating international terrorism, strengthening trade relations, and revitalizing the Egyptian economy. Multinational exercises, U.S. assistance to Egypt's military modernization program (valued at \$1.3 billion annually), and Egypt's role as a contributor to various UN peacekeeping operations continually reinforce the U.S.-Egyptian military relationship. Egypt is our indispensable partner in the quest for regional peace, and it works closely with the U.S. to that end.

Political System: The Egyptian Constitution provides for a strong President empowered to appoint one or more Vice Presidents, the Prime Minister, the Cabinet, and Egypt's 26 provincial governors. President Hosni Mubarak was reelected in September 1999 to a fourth 6-year term. The bicameral legislature includes the law-making People's Assembly and a consultative upper house, the Shura Council. People's Assembly elections were held in late 2000 for a five-year term and elections for one-third of the Shura Council seats were held in May 2001.

The National Democratic Party (NDP) has been the ruling party since its foundation in 1978. It effectively controls local and national government. Within its ranks are both members who favor greater economic and political reform as well as members who oppose reforms. There are more than a dozen recognized opposition parties, all of them small. Some of these parties have members in the People's Assembly and the Shura Council.

Terrorism/Political Violence: There have been no confirmed terrorist incidents in Egypt since November 1997, attributable at least in part to the concerted, successful Egyptian Government counter-terrorist campaign. Previously, extremist groups have staged attacks on Egyptian Government officials, security forces, prominent individuals, and tourists. While terrorist attacks do not pose a credible threat to Egypt's government, they could threaten the business climate and Egypt's vital tourist industry. The violence in Israel and the Palestinian territories since October 2000 has not spilled over into Egypt, although demonstrations have occurred in various parts of the country in response to events there.

There were isolated incidents of vandalism of U.S.-linked businesses during anti-Israeli demonstrations in April 2002. There also has been a boycott campaign against American and products motivated by perceptions of an American bias towards Israel in the conflict. The campaign had some impact on sales, chiefly of high profile U.S. franchise restaurants and locally produced, U.S.-branded consumer goods. The Government opposes the boycott and has publicly countered it by stressing the negative impact on Egyptian

owners and workers. The overall security atmosphere for U.S. firms operating in Egypt remains excellent.

FURTHER RESOURCES

Additional information on economic and business issues in Egypt can be obtained from a number of sources in the U.S. and Egyptian Governments, as well as business and research institutions. Below are several websites that may be of further interest. The Embassy takes no responsibility for non-U.S. Government sites.

U.S. GOVERNMENT SITES

www.usembassy.egnet.net

homepage of the U.S. Mission to Egypt

www.exim.gov

Export-Import Bank of the United States

www.opic.gov

Oversees Private Investment Corporations

www.usaid.gov

U.S. Agency for International Development

www.tda.gov

Trade and Development Agency

www.ita.doc.gov

includes all homepages of International Trade Administration ITA entities

www.ita.doc.gov/uscs/egypt

home page of the Commercial Service in Egypt

www.ita.doc.gov/tic

home page of the Trade Information Center of the U.S. Department of Commerce

EGYPTIAN GOVERNMENT SITES:

www.alhokoma.gov.eg

Egypt's government-on-line homepage, with links to many ministries

www.idsc.gov.eg

home page of the Cabinet Information and Decision Support Center

www.cbe.gov.eg
Central Bank of Egypt

www.moft.gov.eg
Ministry of Foreign Trade

www.mpe-egypt.com
Ministry of Public Enterprise

www.mfa.gov.eg
Ministry of Foreign Affairs

www.capmas.gov.eg
Central Agency for Public Mobilization and Statistics CAPMAS

www.egyptse.com
Cairo and Alexandria Stock Exchange

NON-GOVERNMENTAL SITES

www.eces.org.eg
Egyptian Center for Economic Studies

www.amcham.org.eg
American Chamber of Commerce in Egypt

www.erf.org.eg
Economic Research Forum for the Arab states and Turkey

www.us-egypt.org
U.S.-Egypt President's Council

STATISTICAL ANNEX

COUNTRY DATA

Population:	67.9 million
Population Growth rate:	2.02%
Religions:	Muslim 90% - Christian 10%
Government System:	Presidential
Languages:	Arabic
Work Week:	Sat.- Wed (gov); Sun-Thurs (bus.)

DOMESTIC ECONOMY

National Accounts

Egyptian fiscal year (July-June)

US\$ billions unless stated otherwise

	FY98/99	FY99/00	FY00/01	FY01/02
GDP (current prices, LE billion)	302	339	362	388
GDP (current prices, USD billion)	89.2	98.7	96.9	87.8
GDP real growth rate (%)				
Official government figures	6.3	5.1	3.3	3.1
Consensus of other estimates		4		1.5
GDP/Capita USD	1381	1421	1421	1421
Government Spending/GDP (%)	N/A	32.7	32.5	33.7
Consolidated Fiscal deficit/GDP	N/A	1.2	2.1	5.0
Inflation (%)	3.8	2.8	2.4	N/A
Unemployment (%)	8.2	7.9	8.4	9.0
Foreign Exchange Reserves	19.3	15.13	14.24	13.79
Reserves/months of imports	12.7	10.2	10.4	9
Avg. Exch. Rate for USD1.00	3.396	3.446	3.7	4.42
Debt service ratio (%)	7.9	8.1	8.0	10
Total Foreign debt/GDP	28.2	27.8	27.8	29.5
U.S. assistance (U.S. Fiscal Year)	2.075	2.035	1.995	1.955
Military	1.3	1.3	1.3	1.3
Economic	0.775	0.735	0.695	0.655

Sources: Egyptian government, IMF, World Bank, & Embassy estimates based on those sources

Key Sectoral Statistics	1998	1999	2000	2001
Tourism*				
Revenues (USD million)	2564	3904	4345	3800
Total Arrivals (millions)	3.454	4.797	5.506	4.648
Energy and Petroleum **				
Oil (crude) (avg. thous. barrels/day)	834	852	710	639
Gas (bill. cubic feet/day)	1.2	1.4	1.7	2.4
Electricity (mill, MWH)	62.3	67.9	72.9	75.6
Agriculture*** (million metric tons)				
Wheat	6.0	6.4	6.4	6.2
Rice (milled)	2.8	3.7	3.9	3.6
Sugar	1.2	1.4	1.3	1.4
Cotton (thousand metric tons)	230	233	200	310
Internet Usage**** (No. of Users 000)	100	150	560	600

* Ministry of Foreign Trade

**Ministry of Petroleum, Ministry of Foreign Trade (Electricity figures for fiscal years)

*** US Dept. of Agriculture, cotton is marketing year: Aug.-Sep.

****Internet usage: industry sources

TRADE AND INVESTMENT

US\$ millions

	FY98/99	FY99/00	FY00/01	FY01/02*
Merchandise Exports	4445	6388	7078	4948
Petroleum and related products	1018	2284	2650	1495
Cotton and related products	817	573	614	359
Merchandise Imports	17008	17860	16432	10929
Consumer Goods	2902	2996	2865	2068
Intermediate Goods	5341	4210	3972	2879
Capital Goods	5575	5639	3696	2408
Trade Deficit	12563	11472	9354	5980
Services (net)	5970	5630	5578	2871
Tourism Revenues	3235	4314	4317	2544
Suez Canal Revenues	1771	1781	1843	1364
Current Account Balance	-1742	-1163	-33	-186.1
Foreign Direct Investment (flow)	711	1656	509	388
Portfolio Investment (flow)	-174	473	260	67

* Figures for FY 2001/2002 cover three fiscal quarters July 01 - March 02

Source: CBE and Ministry of Foreign Trade

US TRADE AND INVESTMENT

Calendar year

US\$ millions

	1998	1999	2000	2001
U.S. Exports to Egypt	3060	3025	3334	3202
U.S. Imports from Egypt	660	617	888	778
Trade Balance with Egypt	(2400)	(2408)	(2446)	(2425)
U.S. FDI (stock)	1963	2190	2735	3068

Source: U.S. Department of Commerce